Internal Revenue Service

memorandum

CC:TL-N-9547-91
FS:IT&A:MLOsborne

date: OCT 31 1991

to: District Counsel, [redacted] CC:[redacted]
Attn: [redacted]

from: Assistant Chief Counsel (Field Service) CC:FS

---

subject: [redacted]
CEP case

This is in response to your request for field service advice dated August 2, 1991.

ISSUE

After determining the I.R.C. § 481(a) adjustment resulting from the repeal of the installment method for retailers, whether Section 10202(e)(2)(B) of the Revenue Act of 1987 allows [redacted] to spread the adjustment over 4 years.

CONCLUSION

If the entire section 481(a) adjustment is attributable to [redacted], the year immediately preceding the year of change, [redacted] must include the adjustment into income in [redacted]. However, if computations under Rev. Proc. 84-74 indicate that the section 481(a) adjustment is not completely related to [redacted], the year immediately preceding the year of change, then either the 67 percent rule or Section 10202(e)(2)(B) would apply, resulting in a spread of the adjustment anywhere from 1 to 4 years.

FACTS

[redacted] ([redacted]) is a calendar year corporation that primarily manufactures [redacted] and related products. [redacted]'s merchandise is divided into two general types, everyday and seasonal. The seasonal merchandise is further divided into two general types, Spring and Christmas. In [redacted], [redacted] adopted an installment sales plan to report sales of Christmas merchandise. Also in [redacted], the Internal Revenue Service issued a private letter ruling holding that [redacted]'s installment sales plan for its Christmas merchandise qualified under Treas. Reg. § 1.453-2(b)(1).

In [redacted], the [redacted] District questioned [redacted]'s use of the installment sales plan for its Christmas merchandise. The District requested technical advice as to whether [redacted] was "regularly selling" merchandise on the installment sales plan

under section 453A. The District argued that [redacted] was not "regularly selling" merchandise because it did not offer the installment method for all of its sales of seasonal merchandise. The District also raised the issue of whether [redacted]'s ruling letter should be revoked retroactively because [redacted] failed to disclose the fact that there was a pending examination at the time the installment ruling was requested.

On [redacted], the Corporate Tax Division issued a technical advice memorandum holding that [redacted] was not "regularly selling" merchandise on the installment sales plan under section 453A, and revoked the private letter ruling pertaining to [redacted]'s installment sales plan. The private letter ruling was revoked on a prospective basis since the non-disclosure was immaterial.

The Service revoked the private letter ruling as of January 1, 1988, the effective date of the Revenue Act of 1987. The Revenue Act of 1987 repealed the installment method for dealers in personal property. Thus, the issue of whether a person is "regularly selling" on the installment method became irrelevant for dealers of personal property. In order to avoid [redacted] arguing that it is entitled to use the installment method from [redacted], up to the date of the issuance of the technical advice memorandum (March 24, 1988), the Service made the revocation of the private letter ruling effective on the same day as the repeal of the installment method for dealers.

ANALYSIS

Section 10202(e)(2)(B) of the Revenue Act of 1987 provides that the amount of gain that remains to be recognized on installment obligations arising out of a dealer disposition occurring after February 28, 1986, and before January 1, 1988, is to be taken into account as a section 481(a) adjustment. The adjustments may be spread over a period no longer than 4 taxable years. Section 10202(e)(2)(B)(ii)(III) of the Revenue Act of 1987.

In determining the spread for the 481(a) adjustment, the amount of the section 481(a) adjustment is to be taken into account under the principles of Rev. Proc. 84-74, 1984-2 C.B. 736; however, "the adjustment period is generally 4 taxable years rather than 6 taxable years." H.R. Conf. Rep. No. 3545, 100th Cong., 1st Sess. 927 (1987), 1987-3 C.B. 207.

Section 5.06 of Rev. Proc. 84-74 provides the rules for determining the appropriate period for taking into account a section 481(a) adjustment. The period may vary from taking the adjustment into account entirely in the year of change or ratably spreading the adjustment over the number of tax years the

taxpayer has used the method of accounting that is being changed. In all instances, the period is not to exceed 6 years.

In applying Section 10202(e)(2)(B)(ii)(III) of the Revenue Act of 1987 to the principles of Sec. 5.06 of Rev. Proc. 84-74, it appears that Congress intended that the taxpayer first determine whether the adjustment is attributable to the year preceding the year of change. If the adjustment is completely attributable to the year preceding the year of change, then the adjustment is made in the year of change.

If the adjustment is not completely attributable to the year preceding the year of change, the 67 percent rule is then applied. The 67 percent rule requires that the taxpayer determine whether 67 percent or more of the net amount of the section 481(a) adjustment is attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change. If so, the highest percent attributable to the 1, 2, or 3-tax year period is to be taken into account ratably over a 3-year tax period beginning in the year of change. See Section 5.06(1)(b) of Rev. Proc. 84-74. See also Section 5.14 of Rev. Proc. 84-74 for a comprehensive example of the application of the 67 percent rule. The balance of the adjustment is then spread over the remaining number of years the taxpayer used the method of accounting that is being changed.

If the 67 percent rule is also inapplicable, the total adjustment is to be taken into account ratably over the number of years the taxpayer has used the method of accounting that is being changed. However, in both instances, the period is not to exceed 6 years. Section 10202(e)(2)(B)(ii)(III) of the Revenue Act of 1987 limits this period to 4 years.

Thus, for [redacted], it is necessary to first determine whether the $[redacted] section 481(a) adjustment is attributable to the year preceding the year of change. The amount attributable to the tax year immediately preceding the year of the change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount of the adjustment that would have been required under section 481(a) if the same change had been made in the preceding year.

Based on telephone discussions with you, we assume that the section 481(a) adjustment is attributable to the tax year preceding the year of change, resulting in the total net adjustment taken into income in the year of change. Thus we conclude that [redacted] must take the total $[redacted] adjustment in [redacted], the year of change. If this is not the case, the 67 percent test must be applied. If the 67 percent test is inapplicable, then the total net adjustment is to be taken into account ratably over a period not to exceed 4 years.

DANIEL J. WILES

By: Gerald M Horan

GERALD M. HORAN
Senior Technician Reviewer
Income Tax & Accounting Branch
Field Service Division